PETITION FOR A WRIT OF CERTIORARI

No. 167

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In the Supreme Court of the United States

OCTOBER TERM, 1954

JOHN D. SNOW AND GRACE K. SNOW, husband and wife,

Petitioners,

vs.

UNITED STATES OF AMERICA and CALVIN E. WRIGHT, Collector of Internal Revenue for the District of Idaho,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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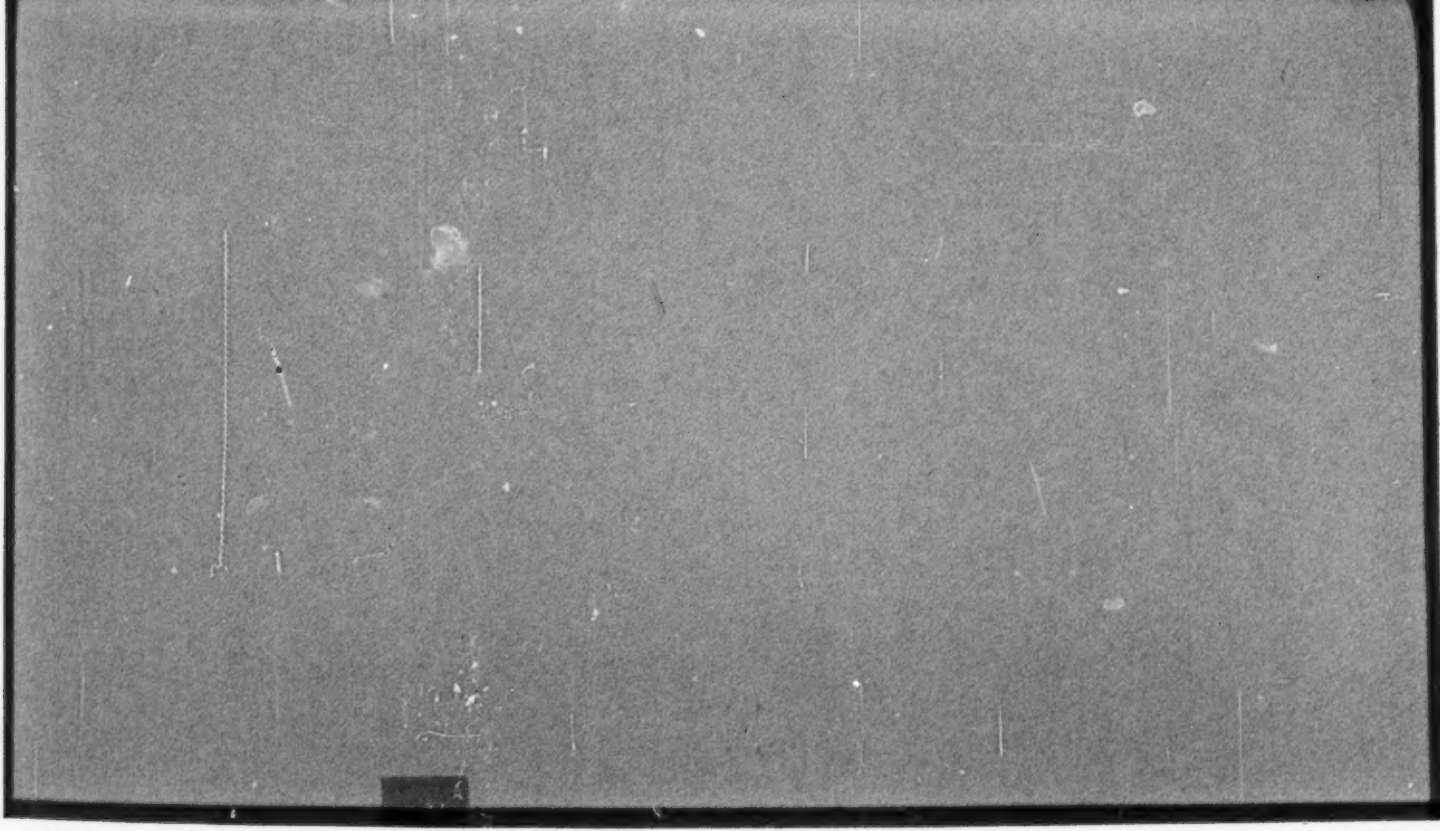

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute Involved	2-3
Statement	3-8
Reasons for granting the Writ	8-13
Conclusion	13
Appendix A—Opinion Below	14-32
B—Internal Revenue Code, 26 U.S.C. 1946 Secs. 117, 182, 183, 188	33
Idaho Code, Secs. 53-324, 53-325, 53-326, 53-327	33-36

CITATIONS

Cases:

Commissioner of Internal Revenue v. Morris Shapiro 6th Cir. 125 F. 2d, 532 12

Commissioner of Internal Revenue v. Smith, 5th Cir. 173 F. (2d) 470 12

Estate of Lowenstein v. Commissioner, 12 T.C. 694 12

Ford v. Commissioner, 6 T.C. 499 12

Humphrey v. Commissioner, 32 B.T.A. 280 12

Hatch v. Commissioner of Internal Revenue, 9th Cir. 198 F. 2d. 26 ... 11

Long v. Commissioner Internal Revenue, 5th Cir. 173 F. 2d, 474, Cert. Denied 338 U.S. 818 12

McClellan v. Commissioner, 2nd Cir. 117 F. 2d, 988 12

Meyer v. U. S., 213 F. 2d, 278 ..... 8, 9, 10

Swiren v. C.I.R. 183 F. 2d, 656, Cert. Denied 340 U.S. 912 9-10

Thornley v. Commissioner, 3rd Cir. 147 F. 2d, 416 12

United States v. Landreth, 5th Cir. 154 F. 2d, 340 12

United States v. Shapiro, 8th Cir. 178 F. 2d, 459 12

Watson v. Commissioner, 345 U.S. 544 10

Statutes:

26 U.S.C. 1946 ed. Sec. 117 ..... 2, 7, 12

26 U.S.C. 1946 ed. Secs. 182, 183, 188 ..... 2, 12

Idaho Code, Secs. 53-324, 53-325, 53-326, 53-327 ..... 3, 12

28 U.S.C.A. Secs. 1340-1346 7

Miscellaneous:

23 Law Week, 1173 9

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on May 3rd, 1955.

OPINIONS BELOW

The opinion of the United States District Court,

(R. 40-44) is unreported. The opinion of the Court of Appeals (Appendix 14-31) has not yet been officially reported.

JURISDICTION

The judgment of the Court of Appeals, 9th Circuit, was entered on May 3, 1955 (R. 137). The jurisdiction of this Court is invoked under 28 U. S. C. A. 1254 (1).

QUESTION PRESENTED

Whether a sale in good faith by a partner of his interest in a continuing partnership is a wholly capital transaction resulting in the realization of a long term capital gain as defined by 26 U.S.C., Section 117 (Appendix B, p. 32), when such interest has been held, as in the case at bar, for a period of more than six months, or whether selling partner's interest in undistributed gains of partnership during fiscal year to the date of sale and added to selling partner's capital account on the books of the partnership must be segregated from other partnership assets and treated as ordinary income.

STATUTES INVOLVED

The pertinent statutory provisions cited below are printed in full in Appendix B, infra.

Internal Revenue Code, 26 U.S.C. 1946 ed. Sec. 117, Sec. 182, Sec. 183, Sec. 188, (Appendix B, p. 32.)

Idaho Code, Secs. 53-324, 53-325, 53-326, 53-327, (Appendix B, p. 33-34.)

STATEMENT

In years 1944 and 1945, John D. Snow, hereinafter referred to as the taxpayer, was associated as a partner with Burdell T. Curtis and R. L. Simplot for the purpose of transacting a produce and brokerage business in the growing, storage, purchasing, selling, shipping and warehousing of vegetables, farm produce and farm products of every kind, nature and description. The amount of capital contributed by each of the partners as follows (R. 60):

John D. Snow	$ 71,323.37
Burdell T. Curtis	71,224.87
Robert Simplot	164,719.08

Snow's share of the loss and profit was 25 per cent. (R. 60).

The book value of all assets and liabilities of the partnership, together with the interest and proprietorship of Snow as of February 28, 1945, as shown by the balance sheet of the books on that date (R. 60-61) was as follows, (R. 61, 62):

ASSETS

Current Assets:		
Accounts Receivable	$ 80,671.41	
Idaho Bank & Trust Company	87,216.50	

Inventory	482,277.71	$650,115.62
Fixed Assets:		
Warehouse & Cellar Equipment	9,639.87	
Less Depreciation Reserve	1,187.41	8,452.46
Office Equipment	6,675.13	
Less Depreciation Reserve	660.00	6,015.13
Cars & Trucks	11,299.32	
Less Depreciation Reserve	1,112.78	10,186.54
Real Estate		294.71
		$675,064.46

LIABILITIES

Current Liabilities:		
Notes Payable	$170,000.00	
Withholding Tax	731.80	
Social Security	561.65	$171,293.45
		$503,771.01

PROPRIETORSHIP

John D. Snow Investment March 1, 1944	$71,323.37

Add Net Increase	$97,555.14	
Less Withdrawals	35,032.00	
Net Increase in Proprietorship	62,523.14	$133,846.51

* * * * *

On or about the 1st day of February, 1945, and prior to the close of partnership transfer, because of illness and other reasons, Snow entered into negotiations with the other partners for the sale of his one-fourth interest in the partnership. Such negotiations continued until about February 23, 1945, at which time an agreement was reached whereby Snow agreed to sell and other partners agreed to buy Snow's entire one-fourth interest. This agreement was consummated by the execution of a written assignment (R. 62) which provided as follows (R. 63):

> Now, therefore, for and in consideration of the sum of Ten Dollars and other good and valuable consideration to the assignors in hand paid by the assignees, receipt whereof is hereby acknowledged;
>
> The Assignors do hereby sell, assign, transfer, and set over to the Assignees, to each of them,

> an equal undivided one-half interest therein, all of the right, title and interest of every kind or nature of the Assignors in and to all of the property and assets of said partnership and of J. D. Snow individually in the capacity of one of the partners in said partnership, including (but not limited to) all lease interests, accounts receivable, notes receivable, personal property, real property and the interest of the Assignors in the Capital Account of said partnership.

After the sale Snow retained no interest whatsoever in the partnership, or any of the property, and had no right to participate in future profits, and was protected against liability for existing and future partnership debts. The District Court expressly found that the transaction was a sale in good faith of Snow's entire interest in the partnership assets at a fixed price to the remaining partners, and that after the sale the business continued as a going business operated by the purchasers. (R. 63).

On a reaudit of the partnership books for the fiscal year ending in 1945, by the Bureau of Internal Revenue additional income amounting to $16,000.00 was developed. (R. 89). No part of this tax was assessed to the taxpayer herein, but was assessed to the then surviving partner, R. L. Simplot, (R. 89).

Mr. Snow and his wife filed individual tax returns for the calendar year 1945 in which the income realized from the sale of their interest in the partnership was reported as gain realized from the sale of a capital

asset and income taxes were paid in the respective amounts shown therein (R. 64).

On January 7, 1949, the Commissioner assessed additional amounts, with interest, against both taxpayers on the ground that Snow's distributive share of the partnership income for its fiscal year ended February 28, 1945, was $97,555.14 and that this amount was taxable as ordinary income rather than income from the sale of a capital asset. The sums assessed were paid and claims for refunds were then filed by both taxpayers. Such claims were disallowed by the Commissioner on November 7, 1951. (R. 64-65, 90).

Thereafter the taxpayers filed an action in the United States District Court for the District of Idaho for recovery of said additional assessments, jurisdiction for said acting being conferred by 28 U.S.C.A. Sections 1340 and 1346.

The District Court stated as its conclusion of law (1) that the transaction here was a bona fide sale of a one-forth interest in a partnership and that the gain therefrom was from a sale of capital asset as defined by Section 117 of the Internal Revenue Code; and (2) that the taxpayers were entitled to judgment for the amount of the additional assessments with interest as allowed by law. (R.66).

Judgment was accordingly entered for the amounts indicated (R.52-54).

From this judgment an appeal was taken by respondent herein to the United States Court of Appeals, 9th

Circuit. The judgment of the District Court was reversed by the latter court (R.137).

REASONS FOR GRANTING WRIT

1. The decision of the court below in the instant case (R. 123-136) is squarely in conflict with the decision of the Court of Appeals of the 7th Circuit in MEYER v. UNITED STATES, 213 Fed. 2d, 278,

The facts in the Meyers case, supra, are substantially identical with the facts involved herein. The court below recognized this similarity as is seen from the following excerpt from its opinion, (Appendix p. 24.)

> "However, in 1954, the 7th Circuit was presented with a fact pattern which is highly comparable to the case at bar. See Meyers v. United States, 213 Fed. 2d, 278."

The identitly of issues is apparent from the following brief resume of facts in the Meyers case. The taxpayer sold a one-fourth interest in a going partnership at book value. The taxpayer reported his individual income on a cash and calendar year basis. The partnership was on an accrual and fiscal year basis. The partnership interest was sold as of February 28, 1945, and the taxpayer received a check in payment therefor in an amount equal to his original capital investment plus unaccumulated, unwithdrawn partnership profits credited to his capital account on the books of the partnership to the date of sale. For the calendar year of 1945 the taxpayer reported a capital gain on the amount of his capital account as shown by the books in

excess of his original contribution. The Collector of Internal Revenue took the position that the taxpayer's gain should be reported as ordinary income and levied an additional assessment accordingly. The taxpayer paid such additional assessment, filed a claim for refund and after disallowance thereof filed suit for recovery in the United States District Court. The District Court held adversely to the taxpayer, which decision of the District Court was reversed by the Court of Appeals. (Meyers v. U. S. supra).

Although the fact pattern in the Meyers case was conceded to be substantially the same as in the present case the Court of Appeals in the instant case expressly refused to follow the Meyers decision.

The United States Law Week (23 Law Week 1173) in Summary and Analysis issued May 17, 1955, prefaces its current review of the instant case with the following heading:

> "9th Circuit differs with 7th Circuit on Tax Treatment of Partnership Sale."

The District Court in the present case rendered its opinion (R. 40-44) and arrived at the same conclusion as arrived at in the Meyers case before the decision in the Meyers case had been officially reported.

2. Although some superficial differences are pointed out by the Court below, it is believed that the decision in the instant case is also in conflict with the decision of the Court of Appeals, 7th Cir. in Swiren v. C.I.R., 183 Fed. 2nd, 656, Cert. Denied 340 U.S. 912. The court below concedes that this decision supports

Petitioners' contention. We quote from the opinion:

> "Two cases in the 7th Circuit support appellees contention. The first is Swiren v. C.I.R., 183 Fed. 2nd, 656, Cert. denied 340 U.S. 912." (Appendix p. 23.)

3. Clearly the question presented is important in the administration of the Internal Revenue Law. As long as the conflict between the 9th and the 7th Circuits is unsolved, uniformity in the interpretation of tax laws will be difficult, if not impossible. Inequities in the administration of these laws have resulted and will continue to result by reason of such conflict. The taxpayer in the Meyers case, supra, was allowed full recovery. On parallel facts the taxpayer in the present case was denied relief. This conflict in tax treatment of cases arising in the 7th and 9th Circuits, and other Circuits following or adopting the view of either Court of Appeals in said Circuits will, of necessity, continue until settled by a decision of this Court. The importance of the question is further emphasized by reason of the many decisions reaching the Court concerning issues similar to those here involved.

4. The decision of the Court below is believed to be erroneous and the conflicting decision of the Court of Appeals of the 7th Circuit in Meyers v. U.S. and Swiren v. Commissioner, supra, correct.

The decisions in these two cases so exhaustively considered the precedents and points at issue that further comment thereon at this point would serve no purpose except to observe that certain of the authorities relied

upon by the Court below, notably the decision of this Court in Watson v. Commissioner, 345 U.S. 544, were also before the Court and analyzed in the Meyers case.

The decision below would appear out of harmony with the prior decision of the lower court in Hatch v. Commissioner of Internal Revenue, 9th Cir. 198 Fed. 2nd, 26, wherein the court states:

> "However, in 1950, the Commissioner of Internal Revenue acquiesced to the overwhelming case authority to the effect that for income tax purposes the sale of a partnership interest in a going concern should be treated as a sale of a capital asset. Such has been the rule in this circuit since the decision of Stilgenbaur vs. United States 9th Cir. 1940, 115 Fed. (2d) 283, 286, 287. For despite the fact that a partner is said to be a co-owner of a 'specific partnership property' his right to possess such property is limited to partnership purposes, and his right to the specific property is non-assignable. Thus, the nature of the interest which a partner actually has in the partnership itself is the right to share in profits and surplus and the right to share in the net value of the partnership after settlement of its affairs. Clarke v. Fiedler, 1941, 44 Cal. App. (2d) 838, 113 Pac. (2d) 275. And this partnership interest is personal property which is separate and distinct from his co-ownership of the specific partnership property. Dudley T. Humphrey v. C.I.R. 1935, 32. B.T.A. 280".

In the Hatch case, supra, the lower Court gave due recognition to the legal status of a partner's interest in a partnership under the laws of the State of California. Similar statutory provisions prevail in the State of Idaho, Idaho Code, Secs. 53-324, 53-325, 53-326, 53-327. (Appendix B, p. 32-34), and other States operating under the uniform partnership Act. There was no dissolution of the partnership as such by the sale made by the taxpayer. The partnership continued to operate and do business under the same firm name and all right to any profit or any distribution thereof passed to the surviving partner as an incident of sale. This fact was clearly recognized by the Government in an early handling of this case, (R. 64). One a re-audit of the books after the tax payer had sold his interest in the partnership certain additional revenue for the fiscal partnership year was discovered. The Government at that time levied and assessed the tax on this additional income to the surviving partner. (R. 64). The trial court properly invoked Sec. 117 of the Revenue Code, rather than Secs. 182, 183 and 188 (Appendix B, 32), considered by the lower Court to be applicable.

It is also felt that the court below failed to give recognition or proper consideration to the following authorities:

McClellan vs. Commissioner, 2nd Cir. 117 F. (2d) 988.

Thornley vs. Commissioner, 3rd Cir. 147 F. (2d) 416.

United States vs. Landreth, 5th Cir. 154 F. (2d) 340.

Commissioner of Internal Revenue vs. Morris Shapiro, 6th Cir. 125 F. (2d) 532.

United States vs. Shapiro, 8th Cir. 178 F. (2d) 459.

Commissioner Internal Revenue vs. Smith, 5th Cir. 173 F. (2d) 470.

Long vs. Commissioner Internal Revenue, 5th Cir. 173 F. (2) 474. Cert. Denied 338 U.S. 818.

Humphrey vs. Commissioner, 32 B.T.A. 280.

Ford vs. Commissioner, 6 T.C. 499.

Estate of Lowenstein vs. Commissioner, 12 T. C. 694.

CONCLUSION

For the foregoing reasons it is respectfully urged that this petition for Writ of Certiorari be granted.

Respectfully Submitted,

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APPENDIX

Appendix A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA and CALVIN E. WRIGHT, Collector of Internal Revenue for the District of Idaho, *Appellants*, vs. JOHN D. SNOW and GRACE K. SNOW, Husband and Wife, *Appellees.*	No. 14,129 May 3, 1955

On Appeal from the United States District Court for the District of Idaho, Southern Division.

Before: HEALY, BONE and POPE, Circuit Judges.

BONE, Circuit Judge:

The appellees filed separate individual income tax returns with the Collector of Internal Revenue for the District of Idaho for the taxable year 1945. In these tax returns, appellees accounted for a community property net gain from the sale of one-fourth interest in a partnership. The entire receipt, minus the basis, was

treated as a capital gain under Section 117 of the Internal Revenue Code. The Collector of Internal Revenue levied an additional tax assessment for the taxable year 1945 on the individual return of John D. Snow in the amount of $20,376.60, including interest, and a like amount upon the individual return of his wife, Grace K. Snow, because the sale was not the sale of a capital asset as reported, but rather resulted in the receipt of ordinary income.

The appellees filed a claim with the Collector for the refund of the assessments and penalties and the claim was disallowed. Appellees brought suit for refund in the lower court to recover the additional sums paid. The court rendered judgment for appellees and the defendants below appealed.

On March 1, 1944, appellee, John D. Snow, associated himself as copartner with Burdell T. Curtis and R. L. Simplot, by written agreement for the purpose of transacting a produce and brokerage business in the growing, storing, purchasing, selling, shipping and warehousing of vegetables, farm produce and farm products of every kind.

From the Stipulation of Facts entered into by the parties we note:

> "That on March 1st, 1944, Burdell T. Curtis, R. L. Simplot and the plaintiff (appellee) herein, after dissolution of the . . . (prior partnership) associated themselves together by written instrument, as copartners under the laws of the State of Idaho, under the firm name and style of Sim-

plot Produce Company, with its principal place of business at Burley, Idaho.

"The amount of capital assets contributed by each of said partners and prospective shares of profit and loss was as follows:

John D. Snow ..... $ 71,323.37

* * * *

"Shares of loss and profit:

* * * *

John D. Snow 25%

* * * *

"That the book value of all assets and liabilities of said partnership, together with the interest and proprietorship of said partners as of February 28, 1945, as shown by balance sheet of said books on said date was as follows: (summarized)

ASSETS

CURRENT ASSETS	$650,115.62	
FIXED ASSETS	24,948.84	
TOTAL ASSETS	$675,064.46	

LIABILITIES

CURRENT LIABILITIES	$171,293.45	

PROPRIETORSHIP

TOTAL PROPRIETORSHIP	$503,711.01	
John D. Snow investment March 1, 1944		$ 71,323.37
Add net increase	$ 97,555.14	
Less withdrawals	35,032.00	
Net increase to proprietorship		62,523.14
Total proprietorship Feb. 28, 1944		$133,846.51

That on the 28th day of February, 1945, plaintiff (appellee) herein, by written agreement, executed an assignment of his interest in said partnership to Burdell T. Curtis and R. L. Simplot. . ."

Appellee husband testified that the "yardstick" for the assignment was his "book value" in the partnership, which was $133,000 (hereafter all figures will be

rounded). It is readily seen from the capital account of appellee (above), and as related in his testimony, that this sum represents original investment of $71,000 plus appellee's share of accrued but undistributed earnings of the partnership for the year in the amount of $62,000. Appellee withdrew $35,000 of the partnership earnings during the year so had only $62,000 undistributed earnings to his credit on the last day of the partnership fiscal year, which was also the day of the above noted assignment.

Appellee did not actually receive the $62,000 credited to him in his capital account but assigned this right to the two remaining partners, Curtis and Simplot. The assignment is in the form of a general statement followed by a specific reference to appellee's interest in his capital account.

We were informed at oral argument (and the partnership return reflects) that the partnership was on the accrual accounting basis. The appellees reported on the cash receipts basis. Although appellees were on the cash receipts tax accounting basis, the lack of actual receipt presents no problem because of the language of 26 U.S.C. § 182:

> "In computing the net income of each partner, he shall include, *whether or not distribution is made to him*—
>
> "(c) *His distributive share of the ordinary net income . . . of the partnership . . .*" (Emphasis added.)

The assignment which was consummated on February 28, 1945, reads as follows:

> "Now, Therefore, for and in consideration of the sum of Ten Dollars and other good and valuable consideration to the assignors in hand paid by the assignees, receipt whereof is hereby acknowledged;
>
> "The assignees do hereby sell, assign, transfer and set over to the Assignees, to each of them, an equal undivided one-half interest therein, all of the right, title and interest of every kind or nature of the Assignors in and to all of the property and assets of said partnership and of J. D. Snow individually in the capacity of one of the partners in said partnership, including (but not limited to) all lease interests, accounts receivable, notes receivable, personal property, real property, and the interest of the Assignors in the Capital Account of said partnership."

The receipt of $133,000 was treated by appellees as proceeds from the sale of a capital asset. The above noted investment in the firm of $71,000 was subtracted from the sale price of $133,000 to obtain what appellees regard as a long term capital gain of $62,000.

The principal concern of the parties in the court below was whether this transaction was a bona fide sale. The trial court found as a matter of fact that the sale was bona fide and then concluded that the entire transaction should be given capital gains treatment.

> "It would seem then that having found the transaction to be a bona fide sale, the conclusion under the law should be that it should be treated as a sale of a capital asset and the plaintiffs should be awarded judgment in their suit for refund."

On appeal, there is no contention that the sale or assignment was not bona fide.

The lower court concluded that the entire gain was derived from the sale of a capital asset:

> "The transaction here involved was a sale of a one-fourth interest in the said partnership, and the gain derived by the taxpayer herein as a result of said sale was derived from the sale of a capital asset, as defined by Section 117, Title 28, USCA."

A general question on appeal is whether the appellees properly included the undistributed earnings in the amount of $62,000 as proceeds from the sale of a capital asset or whether this amount should be treated as ordinary income.

The more precise issue for this court to consider is whether appellees' share of the partnership ordinary income can be transformed from ordinary income to capital gain by regarding the entire transaction as the sale of a capital asset.

Appellees argue that an interest in a partnership is such that the partner's right to accrued ordinary in-

come owing to him and credited to him on the partnership books is absorbed in the greater partnership interest and should not be treated separately. In support of this argument appellees point out that partnership property cannot be sold by one partner without the consent of the other partners. The property is held as tenants in partnership. Hence, any interest in the partnership must be an undivided interest sold as an indivisible whole.

This argument is true only as to a partner's right in *specific partnership property* and is not true as to the *capital account* of an individual partner, at least for tax purposes. His share of the accrued partnership ordinary income for the year ($97,000) was credited to him *personally* on the books and subject to withdrawal as well as individual taxation.

Appellee husband had personally drawn $35,000 from this account during the year and admits this amount to be his ordinary income. Yet, as to the taxpayer's remaining share of the accrued partnership ordinary income ($62,000) which he did not actually draw, but assigned to the remaining partners, the taxpayer asserts that this must be regarded as part of his interest in a capital asset.

26 U.S.C. 182, referred to above, sets forth:

> "In computing the net income of each partner, he shall include, whether or not distribution is made to him—
>
> * * * *

"(c) His distributive share of the ordinary net income . . . of the partnership, computed as provided in section 183(b)."

This statutory command is quite clear. It demands that a partner include in his tax computation his share of the partnership ordinary income whether he receives it or not. Section 183(b) permits him to treat his share of profit realized by the partnership from the sale of a capital asset as if he individually had realized the gain from the sale of a capital asset. Otherwise, he reports his share of the partnership ordinary income as his own ordinary income, whether he receives it or not. We find no room to doubt that a partner must report his *accrued share* of partnership ordinary income as his own ordinary income, whether he receives it or not.

Appellees argue that this remaining amount of $62,000 which was credited to his account should not be regarded as his ordinary income because this was merely a bookkeeping entry and in reality there was not cash amounting to $62,000 which Snow could pick up at any time. While bookkeeping entries are to an extent fictions, nonetheless they represent the method by which profits are computed, and are the required basis for computing income tax.

This decision does not in any way rest upon the doctrine of *Williams v. McGowan*, 152 F.2d 570 (2 C.A.). It assumes a full acceptance of the holdings of *Stilgenbaur v. United States*, (C.A. 9) 115 F.2d 283, and *Hatch's Estate v. C.I.R.*, (C.A.9) 198 F.2d 26,

to the effect that an interest in a partnership is a capital asset. However, we have no desire to extend *Hatch's Estate v. C.I.R.* beyond all normal and statutory bounds and ignore the fundamental rule that income derived from a capital asset is ordinary income.

Two cases in the Seventh Circuit support appellee's contention. The first is *Swiren v. C.I.R.*, 183 F.2d 656, cert. denied 340 U.S. 912. The court in the *Swiren* case was apparently satisfied that its decision should follow when it determined that the subject matter of the sale was that of a capital asset. The court concluded its opinion:

> "The Commissioner and the Tax Court, while correct in part in regarding as a capital asset taxpayer's unrecovered net investment and allowing recovery therefor in full amount, failed to recognize that, as a matter of law, taxpayer's partnership interest as a whole was a capital asset within Sec. 117 of the Internal Revenue Code, with the gain attending the sale thereof taxable as a capital gain, and not otherwise."

Judge Kerner, dissenting from the *Swiren* majority opinion, said:

> "The courts have said that the sale of a right to receive ordinary income is not the sale of a capital asset. This is so even if the sale is of something which may be termed 'property.' In such a situation the sale price simply replaces the future income, but the sale price does not convert the

ordinary income into capital gain. *Hort v. Commissioner*, 313 U.S. 28, 61 S.Ct. 757, 85 L. Ed. 1168."

It also appeared to be quite important to the majority of the court in the *Swiren* case that the partnership was on the cash receipts tax accounting basis. In the instant case the partnership was on the accrual basis.

We believe that the *Swiren* case could be distinguished from the case at bar by giving greater attention to the dichotomy between capital gain and ordinary income and by emphasizing the different accounting bases of the partenrships. *However, in 1954 the Seventh Circuit was presented* with a fact pattern which is *highly comparable* to the case at bar. See *Meyer v. United States*, 213 F.2d 278.

In the *Meyer* case the Seventh Circuit reversed the lower court's determination that a partner's distributive share of the accrued earnings must be regarded as ordinary income and cannot be included, upon sale, within the same category as the capital asset which produced the earnings.

The court in the *Meyer* case considered, but refused to follow, the Supreme Court's decision in *Watson v. Commissioner*, 345 U.S. 544, which affirmed our opinion in 197 F. 2d 56.[1] The Seventh Circuit chose to

[1]In Trousdale v. C.I.R., No. 13,108, February 4, 1955, this court expressed in footnote number five:

"We feel much less sure than did the court in the Meyer case that it was able to distinguish the Watson case. A holding that on a sale of an orange grove for a lump sum, the Commissioner may

adhere to its theory announced in the *Swiren* case where it

> ". . . viewed a lawyer's sale of his interest in a partnership law firm as the sale of a capital asset despite the fact part of the purchase price paid him was for amounts due for personal services." 213 F.2d 278, 281.

The court in the *Meyer* case continued:

> "In the Swiren case (183 F.2d 660) the retiring partner was paid, at the time of his withdrawal from the firm, a sum coinciding with the amount of fees uncollected at that time by his firm, plus his share in other assets of the partnership. *We pointed out that 'uncollected fees for work in process not yet completed had not been transformed on the date of taxpayer's sale of his interest into gross income within the meaning of Sec. 183(b)(2),* Internal Revenue Code, 26 U.S. C.A. §183(b)(2).' 183 F.2d 656, 660. *Those fees were for personal services and we particularly observed that 'Taxpayer was on a cash receipts basis, as was the partnership.'* At the same time we there said: '. . . taxpayer's partnership interest as a whole was a capital asset within Sec. 117 of

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segregate and charge as ordinary income so much of the price paid as is found to be the value fairly attributable to the presence of an unmatured crop at the time of sale, might well suggest doubts about the soundness of the decision in the Swiren case."

We now think the **Swiren** and **Meyer** cases in the Seventh Circuit cannot be reconciled with the rationale of the decision in **Watson v. United States, 345 U.S. 544.**

the Internal Revenue Code. . . .' 183 F.2d 660." (Emphasis added.)

The court in the *Meyer* case appears to rely upon its language in the prior *Swiren* case—the *Meyer* case was substantially different in that the partnership in the *Meyer* case was on the accrual tax accounting basis and uncollected fees would be "gross income within the meaning of Sec. 183(b)(2), Internal Revenue Code, 26 U.S.C.A. §183(b)(2)."

The court in the *Meyer* case, as well as the trial court, appeared to be satisfied that capital gains treatment must necessarily follow if it were determined that the subject of the sale could be *labeled* a capital asset and the sale was in good faith. In short, both courts apparently assumed that a taxpayer can sell or assign a right to receive ordinary partnership income and treat any gain as a capital gain, so long as the capital asset which produced the ordinary income is also transferred. The court in the *Meyer* case concluded:

> "The government has urged that this taxpayer has 'realized' partnership profits for the July to February period in question. And *it might also be argued that as to this taxpayer, he had a right to his distributive share of the partnership profits when they were accrued. But we find he sold out his entire partnership interest, quit the firm, and disposed of a capital asset.* He was entitled to the long term capital gain treatment as sought in the complaint filed below." (Emphasis added.)

The lower court in the case at bar concluded:

> "The transaction here involved was a sale of a one-fourth interest in the said partnership, and the gain derived by the taxpayer herein as a result of said sale was derived from the sale of a capital asset, as defined by Section 117, Title 28, USCA."

It is now the overwhelming weight of authority and the law of this circuit that an interest in a partnership is a capital asset.[2] The interest of John Snow *in the partnership* (as contrasted with partnership earnings) was held for more than six months and therefore qualifies for capital gains treatment under Section 117 of the Internal Revenue Code.

However, it is not decisive of the issue here presented to find that the subject matter properly bears the capital asset label. It is a fundamental principle of federal tax law that you must regard any ordinary income derived from an income-producing capital asset as ordinary income. Consequently, the assignment of accrued ordinary income must be treated separately from the assignment of the capital asset which produced the income. This is not an exception to the rule that capital assets held for more than six months shall be given capital gains tax treatment. It is only when a capital asset appreciates in value and is subsequently sold, beyond the six months' period, that the gain realized

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[2]Stilgenbaur v. United States, (C.A.9) 115 F.2d 283; Hatch's Estate v. C.I.R., (C.A.9) 198 F. 2d 26.

may be given capital gains tax treatment under Section 117 of the Internal Revenue Code.

The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. We believe that the statutory provisions referred to above dealing with the taxation of partner's income control the disposition of this case. In addition, we see no logical reason why ordinary income from an interest in a partnership should receive different tax treatment than income from any other capital asset.

Fisher v. Commissioner, 209 F.2d 513, cert. denied June 7, 1954, 347 U.S. 1014, involved a bona fide sale of notes held for more than six months for a greater sum than their face value, since the sale price of the notes was made to reflect the interest due thereon. The taxpayer treated the entire transfer as that of an indivisible sale of a capital asset. The court of appeals affirmed the Tax Court in holding that the taxpayer must treat his right to ordinary income (interest due on the notes) as ordinary income and not capital gain and that in a tax sense it was unimportant that the interest due on the notes (ordinary income) was later collected by the purchaser of the capital asset (notes) rather than being paid to the seller of the notes, since the purchaser of the capital asset in effect paid the interest to the taxpayer when he paid more for the notes than their face value.

In the *Fisher* case the court pointed out that the fundamental error of the taxpayer was his failure to recognize that gain realized upon the sale of a capital asset which has appreciated in value is capital gain; whereas, gain realized by way of income from the capital asset is ordinary income.

The *Fisher* case reviews the touchstone cases in this field of taxation, including: *Helvering v. Horst*, 311 U.S. 112; *Hort v. Commissioner*, 313 U.S. 28; and *Rhodes' Estate v. Commissioner*, 131 F.2d 50. We believe that these cases support the conclusion we reach.[3] It has been the rule since *Lucas v. Earl*, 281 U.S. 111, that income tax cannot be escaped by a tax partner's assigning to another *the right to receive ordinary income*. In the case at bar the partnership had approximately $390,000 of *ordinary income* for the fiscal year ending on February 28, 1945. It is not contested that

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[3]Fisher v. C.I.R., 209 F.2d 513, 514-515:

"While no exact precedents have been cited and none are found, principles governing the characteristics of income are well understood and have been developed by many cases. In Helvering v Horst, 311 U.S. 112, 61 S. Ct. 144, 85 L. Ed. 75, the question presented was whether one who is presently entitled to receive income and who is taxable only on receipt of payment can escape taxation by giving away his right thereto in advance of actual payment. The answer was in the negative. In Hort v. Commissioner, 313 U.S. 28, 61 S. Ct. 757, 85 L. Ed. 1168, the taxpayer acquired by inheritance real estate subject to a lease. It was there held that a lump-sum payment by the lessee for cancellation of the lease 'was clearly a substitute for the rent reserved in the lease' and, thus, taxable as ordinary income to the recipient. In Rhodes' Estate v. Commissioner, 6 Cir., 131 F.2d 50, a sale of dividend rights prior to the time they were payable was held to be ordinary income and not capital gain.

* * * *

"A brief analysis of the petitioner's position will perhaps clarify our view. The petitioner kept his books and made his returns upon a cash receipts basis. Had he chosen the accrual method, the interest payments upon the notes would have been income to him at the time they became due. The law, of course, permits him to adopt either method but the cash receipts basis does not change the character of what he receives from income to capital gain—it merely postpones its taxability

appellees' share of the partnership's ordinary income for the fiscal year ending February 28, 1945, was something over $97,000. Since a partnership is not a tax-paying entity, the partners pay tax upon their share of the partnership earnings, 26 U.S.C. §181.

The tax Court has decided the precise issue here presented on several occasions prior to the *Meyer* case. All of these cases to which our attention has been directed decided the issue contrary to appellees' contention here, and contrary to the *Meyer* decision. We believe that these prior cases were correctly reasoned. Some of the cases with which we are in accord and which decided the specific issue here in question are:

Karsch v. Commissioner, 8 T.C. 1327.

Goodman v. Commissioner, 1950 P-H T.C. Memorandum Decisions, par. 52,-222 which holds that Section 182 requires that a partner report his share of partnership ordinary income as his personal ordinary income whether he received it or not. This requirement is not altered by a sale of a *partnership interest* where

---

until realization. **Floyd v. Scofield**, 5 Cir., 193 F.2d 594. It was said in the **Horst** case, supra: 'But the rule that income is not taxable until realized has never been taken to mean that the taxpayer, even on the cash receipts basis, who has fully enjoyed the benefit of the economic gain represented by his right to receive income can escape taxation because he has not himself received payment of it from his obligor.' [311 U.S. 112, 61 S. Ct. 147] The petitioner received substantially all of his defaulted interest when he sold his notes to Prime, discounted for trading purposes, and it was, in the light of the **Horst** case, unimportant that he received it not from the Florida corporation but from the purchaser of the notes. As was there further said: "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it. * * * The dominant purpose of the revenue laws is the taxation of income to those who earn or otherwise create the right to receive it and enjoy the benefit of it when paid.'"

the books of the partnership show accrued profits credited to the partner selling his interest in the partnership.

Gray v. Commissioner, 1952 P-H T.C. Memorandum Decisions, par. 52,002: "It seems well settled that a partner must return for taxation his portion of the undistributed profits of a partnership whether he ever actually receives these profits or not. [Citations.] In the *Karsch* case we said:

> " 'We have been referred to no authority indicating that the mere sale of a partnership interest converts a partner's distributive share in past earnings upon which no tax has been paid into a capital item or relieves him from the necessity of paying a tax thereon as ordinary income.' "

Bell v. Commissioner, 1953 P-H T.C. Memorandum Decisions, par. 53,-135:

> ". . . The *gain or loss from the sale of the partnership interest is a matter that calls for separate treatment and is not to be confused with the proper reporting of the income earned from the operation of the partnership.*" (Emphasis added.)

The latest determination by the Tax Court of the issue presented to this court is to be found in *Johnson v. Commissioner*, 21 T.C. 733, 738:

> "It is by now well settled that a withdrawing partner is chargeable with ordinary income on his

share of the partnership profits, whether currently distributed or not, up to the time of his withdrawal. [Citations.] This is so notwithstanding that he sells his interest to the continuing partner."

In *LeSage v. Commissioner*, 173 F.2d 826, the court also faced this issue and decided that any part of the sale price of an interest in a partnership which reflected *partnership income* must be regarded as ordinary income of a partner and cannot be given capital gains treatment.

The appellants have urged, and we agree, that the lower court erred in refusing to hold that a portion of the receipts (i.e., the amount equal to John Snow's share of the partnership's net earnings for the partnership year from March 1, 1944, to February 28, 1945) should be taxed as ordinary income under Sections 22 and 182 of the Internal Revenue Code, rather than as capital gain under Section 117.

The judgment of the lower court is therefore reversed and the cause remanded for further proceedings not inconsistent with the views here expressed.

(Endorsed:) Opinion. Filed May 3, 1955. Paul P. O'Brien, Clerk.

Appendix B

INTERNAL REVENUE CODE, 26 U.S.C. 1946 ed.

Sec. 117. Capital Gains and Losses.

(a) Definitions.—As used in this chapter—

(1) Capital assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business, but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade of business, or property, used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23 (1), * * *.

* * * *

Sec. 182. Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

* * * *

Sec. 183. Computation of Partnership Income.

(a) (as amended by Section 9 (c) (1) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231). General Rule—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c) and (d).

Sec. 188. Different Taxable Years of Partner and Partnership.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

IDAHO CODE

Sec. 53-324. Extent of property rights of a partner. The property rights of a partner are :

1. His rights in specific partnership property.

2. His interest in the partnership.

3. His right to participate in the management.

Sec. 53-325. Nature of a partner's right in Specific Partnership Property.—1. A partnership is co-owner with his partners of specific partnership property, holding as a tenant in partnership.

2. The incidents of this tenancy are such that:

a. A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; that he has no right to possess such property for any other purpose without the consent of his partners.

b. A partner's right in specific partnership property is not assignable except in connection with the assignment of the rights of all the partners in the same property.

c. A partner's right in specific partnership property is not subject to attachment or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them or the representatives of a deceased partner, can not claim any right under the homestead or exemption laws.

Sec. 53-326. Nature of Partner's Interest in the Partnership.—A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

Sec. 53-327. Assignment of partner's interest.—1. A conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor, as against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs,

or to require any information or account of partnership transactions, or to inspect the partnership books; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	3
Conclusion	10
Appendix	11

CITATIONS

Cases:

Dixon v. *United States*, 192 F. 2d 82, affirming *per curiam* 96 F. Supp. 986	6
Doyle v. *Commissioner*, 102 F. 2d 86	6
Fisher v. *Commissioner*, 209 F. 2d 513, certiorari denied, 347 U.S. 1014	6
Hatch's Estate v. *Commissioner*, 198 F. 2d 26	5
Heiner v. *Mellon*, 304 U.S. 271	5
Helvering v. *Smith*, 90 F. 2d 590	6
Hort v. *Commissioner*, 313 U.S. 28	6
Kieselbach v. *Commissioner*, 317 U.S. 399	6
LeSage v. *Commissioner*, 173 F. 2d 826	5
Meyer v. *United States*, 213 F. 2d 278	5, 7, 8
Rhodes' Estate v. *Commissioner*, 131 F. 2d 50	6
Swiren v. *Commissioner*, 183 F. 2d 656, certiorari denied, 340 U.S. 912	8
Watson v. *Commissioner*, 345 U.S. 544, rehearing denied, 345 U.S. 1003	6

Statutes:

Internal Revenue Code of 1939:	
Sec. 22 (26 U.S.C. 22)	11
Sec. 117 (26 U.S.C. 117)	11
Sec. 181 (26 U.S.C. 181)	12
Sec. 182 (26 US..C. 182)	4, 7, 12
Sec. 183 (26 U.S.C. 183)	12
Sec. 188 (26 U.S.C. 188)	4, 7, 9, 13

Statutes—Continued

Page

Internal Revenue Code of 1954:
Sec. 701-761 8
Sec. 702 13
Sec. 706 ..... 8, 9, 14

Miscellaneous:

H. Conference Rep. No. 2543, 83d Cong., 2d Sess., pp. 60-61 9
H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A225-A226 9
S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 385-386 9

In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 167

JOHN D. SNOW AND GRACE K. SNOW, Husband and Wife, PETITIONERS

v.

UNITED STATES OF AMERICA AND CALVIN E. WRIGHT, Collector of Internal Revenue for the District of Idaho

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the District Court (R. 40-44) and the opinion of the Court of Appeals (R. 123-136) are unreported.

JURISDICTION

The judgment of the Court of Appeals was entered on May 3, 1955. (R. 137.) The petition

for a writ of certiorari was filed on June 20, 1955. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether, on the sale of a partnership interest, a partner's share of net earnings for the preceding fiscal year should be taxed as ordinary income under Sections 22 and 182 of the Internal Revenue Code of 1939 rather than as capital gain under Section 117.

STATUTES INVOLVED

The pertinent provisions of the statutes involved (Sections 22(a), 117(a)(1), 181, 182(c), 183(a), and 188 of the Internal Revenue Code of 1939, and Sections 702(a)(1), (2) and (8), and (b), 706(a) and (c)(2) of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra,* pp. 11-15.

STATEMENT

The pertinent facts as given in the District Court's amended findings of fact (R. 58-65) and in the stipulation of facts (R. 92-101) are as follows:

On March 1, 1944, petitioner [1] associated himself with two other persons as a partner with a one-fourth interest in a produce and brokerage business and contributed capital assets to the partnership in the amount of $71,323.37. (R. 60.)

On February 28, 1945, the partnership's balance sheet showed that the increase in petitioner's in-

[1] The petitioners are husband and wife. For convenience, the husband will be referred to as the petitioner or taxpayer.

terest since March 1, 1944, was $97,555.14, and that his withdrawals during the year amounted to $35,032. The resulting net increase of $62,523.14 when added to petitioner's original investment amounted to $133,846.51, and was the price at which he sold his interest to the other partners on or about February 28, 1945. (R. 60-63.)

The partnership's tax return for the fiscal year ended February 28, 1945, showed that petitioner's distributive share of ordinary net income for that year (after an appropriate adjustment of the partnership accounts) amounted to $97,555.14. (R. 90.)

Petitioner and his wife filed individual tax returns for the calendar year 1945 and reported all of the income realized from the sale of the partnership interest as gain from the sale of a capital asset. (R. 64.) The Commissioner assessed deficiencies on the ground that the petitioner's distributive share of the partnership's ordinary net income was taxable to him as ordinary income. The deficiencies were paid and this refund suit was filed. (R. 64-65.) The District Court held for the petitioner (R. 40-44) and the Court of Appeals reversed (R. 123-136).

ARGUMENT

1. The court below was correct in holding that the taxpayer, who sold his partnership interest to the other members of the firm, was taxable with ordinary income to the extent of his distributive share of the ordinary net income earned by the

partnership during its full taxable year preceding the sale of his interest in the firm.

A partnership is not a taxpaying organization. Under Section 182 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 12) a partner must include in his individual tax return his distributive share of the ordinary net income and the long - and short-term capital gains earned by the partnership; these items of income retain their separate tax characteristics and the distributive shares are taxable to each individual partner "whether or not distribution is made to him." If the partnership year is different from that of the partner, the partner includes in his tax return his distributive share of the partnership net income for the partnership year ending within or with the taxable year of the partner. Section 188 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 13).

Application of this statutory language to the facts of this case clearly compels the conclusion reached by the Court of Appeals. It is undisputed that the partnership had net earnings of approximately $390,000 for its fiscal year ended February 28, 1945, and that these earnings consisted of ordinary income. (R. 77; Ex. 2, R. 83.) It is also undisputed that during that year the taxpayer's distributive share of those earnings under the partnership agreement was $97,555.14. (R. 90, 97; Ex. 2.) Since the partnership's fiscal year ended on February 28, 1945 (which was also the day on which the taxpayer ceased to be a partner by reason of the sale of his interest), and was

within the taxpayer's taxable year (which was the calendar year 1945), the explicit command of the Code required the taxpayer to report and pay a tax on his distributive share of this ordinary income "whether or not distribution is made to him." See *Heiner* v. *Mellon,* 304 U.S. 271.

Although the courts, including the court below, have generally held that the sale of a partnership interest is to be taxed as the sale of a capital asset (see *Hatch's Estate* v. *Commissioner,* 198 F. 2d 26 (C.A. 9th)), capital gain on the sale cannot properly be extended to the partner's share of undistributed ordinary income earned by the partnership *prior* to the partner's sale of his partnership interest even when this occurs prior to the end of the full tax year of the partnership. As the court below noted (Pet. 30-32), the Fifth Circuit has so held (*LeSage* v. *Commissioner,* 173 F. 2d 826) and the Tax Court has consistently followed this proposition. Only the Seventh Circuit has reached the opposite conclusion. *Meyer* v. *United States,* 213 F. 2d 278.

The correctness of the position of the court below seems fully apparent not only from the statutory provisions governing the manner in which a partner is taxed on his distributive share of partnership income, regardless of whether withdrawn or permitted to remain with the firm, but also from the fundamental principle of taxation, applied by this Court and the lower courts in a variety of circumstances, that a right to receive ordinary income already earned is not converted

into capital gain by a sale. See *Watson* v. *Commissioner,* 345 U.S. 544, rehearing denied, 345 U.S. 1003 (ordinary income realized on sale of citrus grove containing unmatured crops to the extent that the sale proceeds reflected the value of the growing fruit); *Hort* v. *Commissioner,* 313 U.S. 28 (lump sum payment for cancellation of lease treated as in lieu of rent and taxed as ordinary income); *Kieselbach* v. *Commissioner,* 317 U.S. 399 (lump sum condemnation award taxable as ordinary income to the extent that it represented damages for delay in payment); *Fisher* v. *Commissioner,* 209 F. 2d 513 (C.A. 6th), certiorari denied, 347 U.S. 1014 (on sale of note with past due interest, ordinary income realized to the extent that sale proceeds were allocable to the right to the past due interest); *Rhodes' Estate* v. *Commissioner,* 131 F. 2d 50 (C.A. 6th) (sale of right to receive a dividend taxable as ordinary income); *Dixon* v. *United States,* 192 F. 2d 82 (C.A. 6th), affirming *per curiam* 96 F. Supp. 986 (E.D. Ky.) (sale of accounts receivable resulted in ordinary income); *Helvering* v. *Smith,* 90 F. 2d 590 (C.A. 2d); and *Doyle* v. *Commissioner,* 102 F. 2d 86 (C. A. 4th) (receipt by withdrawing partner of lump sum for his interest in uncollected fees was ordinary income).

The taxpayer's position in the present case, in essence, is that his right to receive his undrawn share of profits earned by the firm during the one year when he was a partner became capital gain simply because he sold it to his partners along with

his capital investment in the firm. This position, we submit, is untenable in view of the general principles referred to above and in view of the clear language of Sections 182(c) and 188 requiring the taxpayer to report, as ordinary income, his distributive share of the partnership net income earned during the partnership's full fiscal year which ended within the taxpayer's taxable year.

2. While the rationale employed by the Seventh Circuit in *Meyer* v. *United States,* 213 F. 2d 278, is not harmonious with that employed by the court below, there is an important factual distinction between the cases which negates the existence of the conflict which the taxpayer relies on. (Pet. 8-9.) In the *Meyer* case, the partnership filed its tax returns for fiscal years ending on June 30. The taxpayer there had sold his partnership interest on February 28, 1945, and the issue was whether he should be taxed on his distributive share of the partnership profits earned during the period July 1, 1944, to February 28, 1945.

Although the point is not discussed in *Meyer,* the decision there could mean that the court was impliedly holding that the taxable year of the partnership had not ended on February 28, 1945, when the taxpayer sold his interest, that he was no longer entitled to any distributive share of the partnership's earnings when its taxable year ended on June 30, 1945, and that, consequently, Section 188 of the 1939 Code never had any operative effect.

The question whether the partnership year, at least with respect to the selling partner, terminates prematurely on the sale of a partner's interest, so as to bring Section 188 into effect, is not reached in the present case for here the taxpayer's partnership interest was sold at the termination of the full fiscal year of the firm. Consequently, although we believe that the *Meyer* decision is erroneous, it cannot be said that the Seventh Circuit would necessarily have disagreed with the result of this case in a situation where the partner sells his interest at the close of the partnership's full taxable year.[2]

3. We deem it appropriate to invite attention to the extensive revisions which Congress made with respect to the taxation of partners in Sections 701-761 of the Internal Revenue Code of 1954. Of particular significance here is Section 706(c)(2)(A) of the 1954 Code (Appendix, *infra*, pp. 14-15) which provides that the taxable year of a partner-

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[2] While the taxpayer also claims that *Swiren* v. *Commissioner*, 183 F. 2d 656 (C.A. 7th), certiorari denied, 340 U.S. 912, is in conflict with the decision below (Pet. 9-10), the *Swiren* case is distinguishable for the reason that the income in controversy there related to the selling partner's interest in uncollected fees earned by a partnership on the cash basis. Since the fees had not yet become income to the partnership there was no claim that the taxpayer was to be taxed with his distributive share of partnership earnings but rather the Government's position rested on the ground that there was, in effect, a sale of the right to future income, which should be treated as ordinary income. In the present case the partnership was on the accrual basis; since the income had already accrued to the firm, there is no issue involving the sale of rights to future income.

ship shall close with respect to a partner who sells his entire interest in a partnership (but does not close with respect to the partnership) and that the selling partner's distributive share of the partnership income shall be determined for the period ending with the sale. The committee reports make it perfectly plain that a partner who sells his partnership interest prior to the close of the full taxable year of the partnership will be taxed with ordinary income on his distributive share of the partnership's ordinary income earned prior to the sale. See H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A225-A226; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 385-386; H. Conference Rep. No. 2543, 83d Cong., 2d Sess., pp. 60-61. This explicit statutory provision thus rejects the result reached by the Seventh Circuit in the *Meyer* case under the more general provisions of the 1939 Code. It will also be noted that Section 706(a) of the 1954 Code (Appendix, *infra*, p. 14) contains the same essential provisions as did Section 188 of the 1939 Code so that where, as here, the sale takes place at the end of the full year of the firm, that section by itself would require the same result as was reached by the court below. The question raised by this case, consequently, has little current importance.

CONCLUSION

In view of the foregoing, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY, 1955.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, * * * and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 ((l), * * *.

* * * * *

(26 U.S.C. 117.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) [as amended by Sec. 9(c)(1) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

* * * * *

(26 U.S.C. 183.)

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

(26 U.S.C. 188.)

Internal Revenue Code of 1954:

SEC. 702. INCOME AND CREDITS OF PARTNER.

(a) *General Rule.*—In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

* * * * *

(8) other items of income, gain, loss, deduction, or credit, to the extent provided by

regulations prescribed by the Secretary or his delegate, * * *

* * * * *

(b) *Character of Items Constituting Distributive Share.*—The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

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SEC. 706. TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

(a) *Year in Which Partnership Income Is Includible.*—In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

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(c) *Closing of Partnership Year.*— * * *

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(2) *Partner who retires or sells interest in partnership.*—

(A) *Disposition of entire interest.*—The taxable year of a partnership shall close—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

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Such partner's distributive share of items described in section 702(a) for such year shall be determined, under regulations prescribed by the Secretary or his delegate, for the period ending with such sale, exchange, or liquidation.

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